

Office of Chief Counsel
Internal Revenue Service

memorandum

CC:NER:PEN:PHI:TL-N-4595-99
JCFee

date:

to: Director, Philadelphia Service Center
CASOL/TECHNICAL UNIT, Drop Point 5323
Attention: Mark Dinkin

from: Assistant District Counsel, Pennsylvania District, Philadelphia

subject:

EIN: [REDACTED]; Tax Years: [REDACTED], [REDACTED], and [REDACTED]
Computation Date for Accrual of Deficiency Interest

DISCLOSURE STATEMENT

This advice constitutes return information subject to I.R.C. § 6103. This advice contains confidential information subject to attorney-client and deliberative process privileges and if prepared in contemplation of litigation, subject to the attorney work product privilege. Accordingly, the Examination or Appeals recipient of this document may provide it only to those persons whose official tax administration duties with respect to this case require such disclosure. In no event may this document be provided to Examination, Appeals, or other persons beyond those specifically indicated in this statement. This advice may not be disclosed to taxpayers or their representatives.

This advice is not binding on Examination or Appeals and is not a final case determination. Such advice is advisory and does not resolve Service position on an issue or provide the basis for closing a case. The determination of the Service in the case is to be made through the exercise of the independent judgment of the office with jurisdiction over the case.

You have informally requested our legal advice on the proper date for computing deficiency interest where the taxpayer has elected to apply it overpayments of tax per return to the following year's estimated tax deposits.

ISSUE:

On what date does interest begin to run on a tax deficiency determined for a particular year, where the taxpayer had previously reported an overpayment of tax on its return and elected to have the overpayment credited against the estimated tax liability for the succeeding year.

CONCLUSION

To the extent the taxpayer's deficiency results from an overpayment credit used to satisfy a subsequent year's estimated tax liabilities, deficiency interest will be assessed as of the dates the excessive overpayment credit is applied to the succeeding year's estimated taxes. Interest will be computed as of the original due date of the succeeding year's income tax return, if the excessive overpayment credit was not needed to satisfy specific installments of estimated tax.

FACTS

TAX YEAR APRIL 30, [REDACTED]

[REDACTED] timely filed its tax return for the year ended April 30, [REDACTED], on the extended due date of [REDACTED]. The [REDACTED] return reflected an overpayment of \$ [REDACTED], which [REDACTED] elected to apply to the subsequent tax year's [REDACTED] estimated taxes. Because [REDACTED] did not designate the quarterly installment to which the overpayment should be applied, the Service applied the reported overpayment to the first quarter of the [REDACTED] tax year, pursuant to Rev. Rul. 84-58, 1984-1 C.B. 254. Accordingly, the Service applied the entire overpayment to the first [REDACTED] estimated payment as of [REDACTED].

On audit, the Service determined a deficiency of \$ [REDACTED] for [REDACTED] (more than the amount of reported return overpayment). In determining when deficiency interest would begin to run on the \$ [REDACTED] deficiency, the Service concluded that interest should run on \$ [REDACTED] (equalling the [REDACTED] credit elect to [REDACTED] of the deficiency [REDACTED]), the due date of the first installment of [REDACTED] estimated payments. The interest on the balance of the deficiency was computed from the due date of the [REDACTED] return, of course.

TAX YEAR APRIL 30, [REDACTED]

[REDACTED] timely filed its tax return for the year ended April 15, [REDACTED], on the extended due date of [REDACTED]. The [REDACTED] return reflected an overpayment of \$ [REDACTED], which [REDACTED] elected to apply to the subsequent tax year's [REDACTED] estimated tax liability. Since [REDACTED] did not designate the quarterly installment to which the overpayment should be applied, the Service applied the reported overpayment to the first quarter for the subsequent tax year, pursuant to Rev. Rul. 84-58, 1984-1 C.B. 254.

On audit, the Service determined a net deficiency for [REDACTED] in the amount of \$ [REDACTED] (more than the reported return overpayments of \$ [REDACTED]). In determining when deficiency interest would begin to run on [REDACTED]'s [REDACTED]

deficiency, the Service concluded that interest should run on \$ [REDACTED] (equalling the [REDACTED] credit elect to [REDACTED]) of the deficiency from [REDACTED], the due date of the first installment of [REDACTED] estimated payments. The interest on the balance of the deficiency was computed from the due date of the [REDACTED] return, of course.

TAX YEAR APRIL 30, [REDACTED]

[REDACTED] timely filed its tax return for the year ended April 30, [REDACTED], on the extended due date of [REDACTED]. The [REDACTED] return reflected an overpayment of \$ [REDACTED] which [REDACTED] elected to apply to the subsequent tax year's ([REDACTED]) estimated taxes. Since [REDACTED] did not designate the quarterly installment to which the overpayment should be applied, the Service applied the reported overpayment to the first quarter for the subsequent tax year, pursuant to Rev. Rul. 84-58, 1984-1 C.B. 254.

On audit, the Service determined a net deficiency for [REDACTED] in the amount \$ [REDACTED] (less than the reported return overpayments of \$ [REDACTED] for [REDACTED]). In determining when deficiency interest would begin to run on [REDACTED]'s [REDACTED] deficiency, the Service concluded that interest should run from [REDACTED], the due date of the first installment of [REDACTED] estimated payments.

Claims For Refund

[REDACTED] has now filed claims for refund for each of the tax years discussed herein, with respect to the deficiency interest assessed and paid. The claims are based on use of money principles that have been the subject of recent litigation. [REDACTED]'s position is that since it did not need the entire overpayment to avoid the estimated tax penalty, interest should not begin to accrue until the overpayment is needed or used to pay the installment due. Based on the analysis submitted by [REDACTED] with its claims, the overpayment ("credit elect") is applied as follows:

[REDACTED] OVERPAYMENT CREDIT APPLIED TO [REDACTED]

<u>Installment Period for [REDACTED]</u>	<u>Installment Due</u>	<u>E/S Payment</u>	<u>Overpayment Credit Applied</u>
[REDACTED]	\$ [REDACTED]	\$ [REDACTED]	[REDACTED]
[REDACTED]	\$ [REDACTED]	\$ [REDACTED]	\$ [REDACTED]
[REDACTED]	\$ [REDACTED]	\$ [REDACTED]	[REDACTED]
[REDACTED]	\$ [REDACTED]	\$ [REDACTED]	[REDACTED]

OVERPAYMENT CREDIT APPLIED TO

Installment Period for	Installment Due	E/S Payment	Overpayment Credit Applied
	\$	\$	
	\$	\$	
	\$		\$
	\$	\$	\$

OVERPAYMENT CREDIT APPLIED TO

Installment Period for	Installment Due	E/S Payment	Overpayment Credit Applied
	\$	\$	
	\$		
	\$		
	\$		

LAW AND ANALYSIS

Rev. Rul. 88-98, 1988-2 C.B. 356, holds that when a taxpayer elects to credit an overpayment from a return (i.e. the taxpayer makes a "credit elect") and the credit is applied in full against a particular installment of the succeeding year's estimated tax, interest on a subsequently determined deficiency for the earlier year runs from the due date of that installment on the part of the deficiency equal to or less than the credit elect. Rev. Rul. 88-98 follows Avon Products, Inc. v. United States, 588 F.2d 342 (2d Cir. 1978), in which the court interpreted section 6601(a) to mean that interest on a deficiency can only be charged when

We are constrained to note that there is has been no effort by the Internal Revenue Service to verify the taxpayer's computations of annualized income. The Service has typically accepted the taxpayer's computations on Forms 2220 as filed, without challenging whether reported estimated tax liabilities are correct. We also note, you have not included Forms 2220 in the information provided to us. It is essential that you review the Forms 2220 to verify the instalments amounts and payments as stated in the taxpayer's claim before issuing any refunds.

the tax is both due and unpaid. The date the overpayment becomes a payment on account of the succeeding year's estimated tax determines when the prior year's tax became unpaid for purposes of section 6601(a), and thus when deficiency interest begins to run. Prior to that date the government has had the use of the funds with respect to the prior year's tax.

In May Department Stores Co. v. United States, 36 Fed. Cl. 680 (1996), acq. AOD CC-1997-008 (Aug. 4, 1997), the taxpayer elected to credit an overpayment shown on its 1983 tax return to the succeeding year's estimated tax liability but did not attach a statement to its return indicating the installment to which the Service should apply the credit. A deficiency was determined for the taxpayer's 1983 tax year, and interest was assessed from the due date of the first installment in accordance with Rev. Rul. 88-98. However, the taxpayer had made estimated tax payments sufficient to avoid the addition to tax imposed by section 6655 for 1984 for the first and second installments. The court concluded the Service's application of taxpayer's 1983 overpayment to the first installment did not change the fact that the government had the use of taxpayer's overpayment from the due date of the first installment (May 15) to the date taxpayer filed its 1983 tax return (October 15), since the overpayment was not needed to satisfy any installment of estimated tax due during that period.

In Rev. Rul. 99-40, 1999-40 IRB 1, the Service reconsidered the manner in which deficiency interest is computed in light of the May Department Stores decision. When a taxpayer makes an election to apply an overpayment to the succeeding year's estimated taxes, the credit is applied to unpaid installments of estimated tax due on or after the date the overpayment arose, in the order in which they are required to be paid to avoid an addition to tax for failure to pay estimated income tax under sections 6654 and 6655. The Service will assess interest on a subsequently determined deficiency from the date the credit is applied to the succeeding year's estimated taxes. The unused balance of the credit is deemed effective as a payment of the succeeding year's income tax liabilities as of the unextended due date of the return.

Tax Year April 30, [REDACTED]

For [REDACTED]'s [REDACTED] tax year, the deficiency amount exceeded the overpayment claimed on the return and credited to the [REDACTED] tax year. Therefore, as a result of the deficiency, it was subsequently determined that the taxpayer had not actually been entitled to any part of the overpayment credit (i.e., the credit elect). Nevertheless, under May Department Stores and Rev. Rul. 99-40, the government is deemed to have had the use of the taxpayer's money (i.e., the credit elect amount) until the credit elect

is applied to the subsequent year's estimated tax liability or the subsequent year's income tax liability.

To avoid the [REDACTED] estimated tax penalty, [REDACTED] needed only \$[REDACTED] of the [REDACTED] credit elect in the second quarter. The balance of the credit elect in the amount of \$[REDACTED] (\$[REDACTED] - \$[REDACTED]) is deemed to apply to the [REDACTED] income tax liability on [REDACTED], the due date of the [REDACTED] tax return. Accordingly, interest \$[REDACTED], of the [REDACTED] deficiency should begin to run on [REDACTED], the due date of the second estimated tax [REDACTED] installment; interest on \$[REDACTED] should begin to run on [REDACTED], [REDACTED], the due date of the [REDACTED] return. Deficiency interest on the balance of the deficiency (\$[REDACTED]) should run from the due date of the [REDACTED] return, of course.

Tax Year April 30, [REDACTED]

For [REDACTED]'s [REDACTED] tax year, the deficiency amount exceeded the overpayment claimed on the return and credited to the [REDACTED] tax year. As with the [REDACTED] tax year discussed above, the government is deemed to have had the use of the taxpayer's money (i.e., the credit elect amount) until the credit elect is applied to the subsequent year's estimated tax liability or the subsequent year's income tax liability.

To avoid the [REDACTED] estimated tax penalty, Conrail needed only \$[REDACTED] of the [REDACTED] credit elect in the third quarter (due [REDACTED]) and \$[REDACTED] in the fourth quarter (due [REDACTED]). The balance of the credit elect in the amount of \$[REDACTED] (\$[REDACTED] - (\$[REDACTED] - \$[REDACTED])) is deemed to apply to the [REDACTED] income tax liability on [REDACTED], the due date of the [REDACTED] tax return. Accordingly, interest on \$[REDACTED] of the [REDACTED] deficiency should begin to run on [REDACTED], the due date of the third estimated tax [REDACTED] installment; interest \$[REDACTED] of the deficiency should begin to run on [REDACTED], the due date of the fourth [REDACTED] estimated tax installment; and interest on \$[REDACTED] should begin to run on [REDACTED], the due date of the [REDACTED] return. Deficiency interest on the balance of the deficiency (\$[REDACTED]) should run from the due date of the [REDACTED] return, of course.

Tax Year April 30, [REDACTED]

For tax year [REDACTED], the credit elect amount exceeded the subsequently determined deficiency. However, since, [REDACTED]'s estimated tax liability of \$[REDACTED] per quarter (Total \$[REDACTED]) was fully satisfied by estimated tax payments, none of the [REDACTED] credit elect was required to

avoid the liability. The full credit elect is therefore applied to the [REDACTED] income tax liability as of [REDACTED], the due date of the [REDACTED] return. This serves to defer the running of interest on the full amount of the [REDACTED] deficiency until [REDACTED].

This concludes our advice and recommendation with respect to the application of May Department Stores and Rev. Rul. 99-40. We have not rendered advice on whether a refund of deficiency interest is otherwise appropriate and, as such, we urge you to take steps to verify the validity and timeliness of these claims. You must determine whether the taxpayer's claim is timely pursuant to §6511 of the Internal Revenue Code. We also suggest that you secure and review copies of all relevant Forms 2220 and verify all estimated tax payments before issuing any refunds. You may also consider checking the taxpayer's computation of estimated tax due under the methodology shown on the Forms 2220.

Please feel free to call Attorney James C. Fee, Jr. at 215-597-3442 with any additional questions you may have. We are forwarding a copy of this advice to the Assistant Regional Counsel (Tax Litigation) (CC:NER) and to the Office of Assistant Chief Counsel (Field Service) (CC:DOM:FS) for mandatory 10 day post review. To assure that the National Office has had sufficient time to review our advice, we request that you refrain from taking any action with respect to the taxpayer's claim prior to [REDACTED].

JOSEPH M. ABELE

Assistant District Counsel

cc: Assistant Regional Counsel (Tax Litigation) (CC:NER)
Office of Assistant Chief Counsel (Field
Service) (CC:DOM:FS)